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May 14, 2014

Board of Directors
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

RE: Comments on Proposed Rule: PCA - Risk-Based Capital

Dear Board Members:

This is in response to the proposed changes to current law and regulations governing risk-based capital. The Police FCU appreciates the opportunity to comment on the National Credit Union Administration (NCUA) Board's proposal to revise Prompt Corrective Action related to Risk-Based Capital. Police FCU serves over 11,000 federal, state, and local law enforcement officers and their families in the Washington, D.C. metropolitan area. Our mission is consistent with those who serve in the law enforcement community; i.e., serving your needs - protecting your future. While we don't necessarily oppose the modernization of "examination standards" to more effectively police excessive risk in a credit union's balance sheet, the proposed rule is unnecessary, in our view exceeds the legal authority of the Agency, and if implemented will adversely affect consumers and their ability to seek out competitive financial services.

In our view existing law provides the tools necessary to prevent a recurrence of the debacle that lead to the fallout from the most recent financial crisis. That crisis, to a large degree, was the result of poor management and a lack of effective oversight of those entities that employed excessive risks and thus exposed the entire credit union industry to material losses. More rules are not the answer – proper oversight and the principles of safety and soundness aggressively enforced will accomplish the necessary objectives to preclude a recurrence.

If the Agency's intent is to emulate what is transpiring in the banking industry, I believe an argument can be made that there is no evidence that enhanced risk based capital requirements used by the banking regulators work any better than the "net worth" requirements imposed by current law and policed by NCUA. In fact, empirical evidence would suggest otherwise. Banks have had risk-based capital requirements for over two decades and these requirements neither prevented the crisis of 2007 nor did it stop significant failures in the banking system. Once again, effective oversight is paramount.

The credit union industry has survived what has been termed the worst recession in history, and even by your own standards, last year it had its best year in history. It has survived because the vast majority of credit unions focus on serving their members and not themselves. Most credit union failures, including the Corporate Credit Unions, centered-around poor management of the balance sheet and an unabated appetite for higher yielding investments - all of which could have been avoided with proper oversight and enforcement of existing rules and regulations.

Notwithstanding our view that current laws and regulations grant NCUA the necessary authority to control risks in a credit union's balance sheet, I shall offer some insight on how the Agency's proposals as currently constructed will likely produce unintended consequences that ultimately affect a credit union's ability to serve its membership. Herein below are some observations for consideration:

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1. Several of the risk weightings under the proposed rule appear to be rather excessive; for example, credit union risk weights would be higher than that of banks, thus requiring credit unions to hold more capital than banks for the same assets. This will likely position credit unions at a competitive pricing disadvantage in an already highly competitive marketplace.
2. Using higher risk weights on long-term assets to deal with interest rate risk without also considering liability maturities can be misleading; for example, under the proposed rule, cash balances being held at the Federal Reserve are given a marginal risk weighting of 20 percent. In that the Federal Reserve has been designated as a source for emergency liquidity for the entire credit union industry, there appears to be little risk, if any, in holding cash balance at the Federal Reserve. These reserves are deemed to be highly liquid assets during a time of stress and should carry a 0% risk weighting.
3. Investment risk weightings for credit unions are significantly higher than that of banks. All treasury securities and those securities guaranteed by the NCUA or FDIC carry a 0% risk weight, no matter what the maturity. However, other agency backed securities with no credit risk, such as FMNA and Freddie Mac, are risk weighted based on weighted average. Investments with weighted average lives greater than 5 years are given punitive risk weights of 150% for 5 to 10 year average lives and 200% for average lives greater than 10 years. This compares to 20% risk weightings for similar securities in the banking model. In addition, a 30 year loan mortgage on Police FCU's balance sheet would carry a 50% risk weighting while securitizing the same loan into a 30 year FNMA security, with enhanced liquidity, would carry a 150% risk weighting. The proposed rule should more closely mirror bank risk weightings for investments to avoid positioning a credit union at a disadvantage.
4. Under the Proposed Rule, there is no distinction made on risk weightings assigned to mortgage loans of various maturity and pricing terms. For example, a 30-year fixed rate mortgage receives the same risk weight as a 1-year ARM and a 30-year fixed rate home equity loan is the same risk weight as a variable rate home equity line of credit. The Agency should revisit risk weighting for mortgage loans based on terms and when a loan will re-price. Under the proposed rule, there is no difference between capital requirement for a mortgage portfolio consisting of ARMs and the capital requirements for a credit union that holds all 30 year mortgages in the balance sheet. The capital requirement for adjustable rate mortgages and shorter maturity fixed rate mortgage loans should be lower to take into consideration the reduced interest rate risk associated with adjustable and shorter term mortgage loan products.
5. Why is the one percent deposit in the NCUSIF ignored in the risk-based capital calculation? The NCUSIF deposit is a valid asset that is refundable for a host of reasons, e.g., conversion to a bank or savings institution charter, a credit union converting to private insurance, or perhaps a voluntary liquidation. [In addition, the insurance deposit should not be deducted from the risk-based capital numerator – those deposits are a buffer against NCUSIF losses.]
6. The proposed rule will grant NCUA authority to require a higher minimum risk-based capital ratio for individual credit unions based on a NCUA examiner's judgment. This discretion could lead to an inconsistent interpretation in the application of the rule and will indeed lead to tension between credit union management and the NCUA if the rule is seen as arbitrarily enforced.
7. The NCUA already limits a credit union's investment in CUSOs, under NCUA Rule 712.4, so why impose a 250% risk weighting on CUSO investments? The inflated risk weighting on CUSO investments may hinder collaboration among credit unions at a time when such collaboration is vital to the future success of the industry. Many credit unions are looking at CUSO relationships as a way to consolidate functions in an effort to reduce operating expenses and to offset declining net interest income and non-interest income levels. CUSO investments should be risk weighted at no more than 100%.
8. Rising interest rates and the potential negative impact on credit union earnings, is a major concern to the NCUA and all credit unions. Many credit unions have been selling fixed rate 15, 20 and 30

year mortgages and retaining servicing to reduce interest rate risk in the balance sheet. The value of a servicing portfolio will increase significantly in a rising rate environment as prepayments slow and the average life on the sold mortgages extends. Contrarily, a servicing portfolio will become impaired when interest rates fall and borrowers refinance or prepay their mortgages. A 250 percent risk weighting is excessive and will create less incentive to build a servicing portfolio, which helps protect a credit union's earnings in a rising rate environment and maintain a long-term relationship with its members.

9. Credit unions remain the only financial institutions that do not have access to sources of capital beyond retained earnings. If higher capital standards are to be imposed on the credit union industry under the proposed rule, affording credit unions the ability to raise supplementary capital that counts towards net worth requirements should be an appropriate policy consideration.

In summary, the proposed rule, in its current form, may in the short-term reduce risks to the NCUSIF, but it will do so at a significant cost to credit unions and consumers. It will place credit unions at a competitive disadvantage with banks, particularly when considering the current restrictions of raising supplemental capital, and as a consequence adversely affect consumers.

Sincerely,

Danny C. Gregg

Danny C. Gregg
President and CEO

Cc: Senator Barbara Mikulski
Senator Ben Cardin
Representative Steny Hoyer
Representative Donna Edwards
Representative John P. Sarbanes